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## ABSTRACT

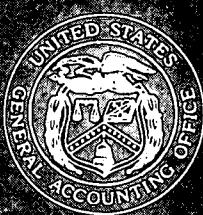
This report examines how the Department of Education calculates the default rate for two federal student loan programs--the Federal Family Education Loan program (FFELP) and the William D. Ford Federal Direct Loan Program (FDLP). The report focuses on three questions regarding these programs: (1) whether there has been an increase in the number of borrowers who entered repayment but subsequently received deferments or forbearances; (2) what the effect on default rates would have been if borrowers in deferment or forbearance were excluded from the default rate calculation; and (3) if the latter method of calculation had been used, would any additional schools have exceeded the 25 percent default rate threshold. The report found that student loans in deferment or forbearance have increased for all types of schools; that default rates rose when borrowers with deferments and forbearances were excluded; and that under the recalculated default rate more schools would have exceeded the 25 percent threshold. The report also notes Department of Education objections to changing the method of calculating the default rate, but concludes by suggesting that Congress consider this change. Appended to the report are sections on scope and methodology and comments from the Department of Education. (CH)

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July 1999

## STUDENT LOANS

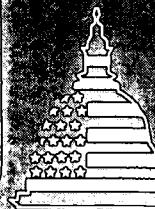
Default Rates Need to  
Be Computed More  
Appropriately

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**Health, Education, and  
Human Services Division**

B-282065

July 28, 1999

**The Honorable William F. Goodling  
Chairman, Committee on Education  
and the Workforce  
House of Representatives**

**The Honorable John L. Mica  
Chairman, Subcommittee on Criminal  
Justice, Drug Policy, and Human Resources  
Committee on Government Reform  
House of Representatives**

Two major federal student loan programs, the Federal Family Education Loan Program (FFELP) and the William D. Ford Federal Direct Loan Program (FDLP), provide funding that is vital to helping students meet their postsecondary education costs. FFELP, formerly known as the guaranteed student loan program, provides loans through private lenders such as banks. These loans are insured against default by state or nonprofit guaranty agencies, which are later reimbursed by the Department of Education. FDLP, often referred to as the direct loan program, provides loans from the federal government through students' schools. The first FDLP loans were made in the fourth quarter of fiscal year 1994. The Department uses student borrowers' experiences with loans from FFELP and FDLP for determining a school's default rate.

In fiscal year 1998, these programs provided student borrowers with nearly 8.4 million loans totaling more than \$30 billion. However, when borrowers fail to meet their financial obligations by not repaying their federal student loans, it is the government that ultimately must pay for this failure. For example, the Department of Education paid \$2.1 billion in default claims from these programs in fiscal year 1998. An accurate measure of student loan defaults at colleges, universities, and vocational schools is an important means for monitoring the extent of financial risk to the Department from its student loan programs. To protect the government from the costs associated with extremely high rates of default, the Department now excludes schools from program participation if their default rate is 25 percent or more for 3 consecutive years.<sup>1</sup>

<sup>1</sup>A school's default rate is the rate at which the school's FFELP and FDLP student borrowers have defaulted on their loans.

You asked us to examine one aspect of the way in which the Department of Education calculates this default rate. The issue involves borrowers who have temporary approval through their lenders or loan services through "deferment" or "forbearance" not to make payments on their loans.<sup>2</sup> In the Department's calculation of a school's default rate, these borrowers are not counted as defaulters, but they do count as a part of the total number of borrowers. As shown below, the number of borrowers in default is divided by a number larger than the total number of borrowers who are actually repaying their loans (see fig. 1). As a result, the default rate is understated.

**Figure 1: Current Method for Calculating Schools' Default Rates**

Number of borrowers who began repaying during the first fiscal year of a 2-year cohort<sup>a</sup> period and defaulted by the end of the second fiscal year (borrowers granted deferment or forbearance status **are not** included).

divided by

Number of borrowers who began repaying during the first fiscal year of a 2-year cohort period (borrowers granted deferment or forbearance status **are** included).

<sup>a</sup>The Department gathers data required for calculating default rates by cohort. Covering a 2-year period, a cohort constitutes a group of student borrowers who began repaying their loans during a given fiscal year and also identifies those in the group who defaulted before the end of the next fiscal year. Although it covers a 2-year period, a cohort is identified by its first fiscal year. For example, borrowers in the 1996 cohort began repaying during the 1996 fiscal year.

As agreed with your offices, we focused our work on answering three specific questions with regard to these calculations:

<sup>2</sup>Deferment is postponement of payments for such reasons as continued study, inability to find work, or economic hardship. Forbearance is permission to temporarily suspend payments, make smaller payments, or extend the time for making payments because of poor health or other acceptable reasons.

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- Over the past several years, has there been an increase in the number of borrowers who entered repayment but subsequently received deferments or forbearances?
- What would have been the effect on the most recent default rates if borrowers whose loans were in deferment or forbearance had been excluded from the default rate calculation?
- Under this alternative method of calculating the default rate, would any additional schools have exceeded the 25-percent default rate threshold?

Appendix I describes our scope and methodology. We conducted our review between August 1998 and May 1999 in accordance with generally accepted government auditing standards.

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## Results in Brief

Between 1993 and 1996, the percentage of borrowers with loans in deferment or forbearance more than doubled, from 5.2 percent of borrowers who had begun repaying to 11.3 percent. This doubling was consistent across the various types of schools, including 4-year and less-than-4-year public and private schools as well as proprietary schools. According to Department of Education officials, the increase was attributable, in part, to provisions of the 1992 amendments to the Higher Education Act of 1965 that eased the requirements for obtaining deferments and forbearances as a way of helping minimize loan defaults.

Excluding borrowers with loans in deferment or forbearance entirely from the calculation of the cohort default rate would have had the effect of increasing the overall default rate from 9.6 percent to 10.9 percent for 1996, the most recent cohort year for which data are available. The proportional increases would have been roughly similar for the various types of schools. For example, the rate at 4-year schools would have risen from 6.8 to 7.7 percent, while the rate at proprietary schools would have risen from 18.3 to 20.1 percent.

For the 1996 cohort, excluding borrowers with loans in deferment or forbearance from the calculation would have increased the number of schools with rates exceeding the 25-percent threshold (for excluding schools from the loan programs) by 181 schools, from 352 to 533—an increase of 51 percent. Under the law, these schools would have become ineligible to participate in student loan programs if their cohort default rate had exceeded the threshold for 3 consecutive years. Since 1991, the Department has denied participation in the programs to more than 1,000 schools because their default rates were too high. Most of the additional

schools that would have exceeded the threshold under the alternative calculation method were proprietary schools, but 12 were 4-year colleges and universities and 57 were public or private schools with degree programs of less than 4 years. Because the number of borrowers with loans in deferment or forbearance has been growing, and because the exclusion of these borrowers from the calculation could have a substantial effect on schools' default rates, the Congress may want to consider requiring an alternative method for computing default rates.

## Background

Default reduction measures were part of the default reduction initiative that the Department introduced in June 1989 in response to the rising default rates in federal student loan programs at that time. According to Department of Education officials, these measures apply to all schools participating in federal student loan programs. Default reduction measures, incorporated into statutes, regulations, and guidance, require schools to provide students with loan counseling; take steps to promote repayment among delinquent borrowers; and, for schools whose default rates exceed certain thresholds, implement a default management plan. Such actions, if properly implemented, reduce loan defaults and the associated federal costs to pay lenders' default claims, as anticipated.

The Department's efforts to reduce historically high default rates for federal student loan programs have paid dividends. Schools' overall default rate hit its high of 22.4 percent in fiscal year 1990 but declined to 9.6 percent for the 1996 cohort. One tool the Department has used to bring greater financial accountability to the programs is the default rate threshold, which was authorized in a 1990 amendment to title IV of the Higher Education Act of 1965.<sup>3</sup> The threshold was instituted as a safeguard to protect the government from the costs associated with schools whose students consistently had exceptionally high default rates. In 1991, under this legislation, the Department began to bar schools from participating in federal student loan programs if their cohort default rates exceeded the statutory threshold of 25 percent for 3 consecutive years.<sup>4</sup>

As provided by section 435(m) of the Higher Education Act of 1965, as amended, the Department establishes a default rate for each school by creating a cohort consisting of all the school's students who are expected to begin repaying their loans in a given year. The Department then determines how many of these students default on their loans in that year

<sup>3</sup>The amendment was part of the Student Loan Default Prevention Initiative Act of 1990 (P.L. 101-508).

<sup>4</sup>This threshold decreased from 35 percent to 25 percent in 1991.

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or by the end of the following year. For a school with 30 or more borrowers<sup>5</sup> beginning to repay their loans, the default rate is the percentage that results from dividing (1) the number of students who begin to repay in a given fiscal year and default in that year or before the end of the next fiscal year (the numerator) by (2) the number of students who are supposed to begin repaying in that given fiscal year (the denominator). For example, if 100 students from a school were scheduled to begin repaying their loans in fiscal year 1996 and 25 defaulted on their loans by the end of fiscal year 1997, the school's 1996 default rate would be 25 percent.

The criterion for determining when a borrower has defaulted for the purpose of being placed in the numerator of the cohort default calculation varies by loan program. For FFELP, a borrower is considered to be in default only if the guaranty agency has paid a default claim to the lender on the borrower's loan. The date the guaranty agency reimburses the lender for the defaulted loan (the "claim paid" date, which is generally after the borrower has been delinquent for over 270 days on a loan payable in monthly installments) is the basis for determining when a borrower is placed in the numerator of the default calculation.<sup>6</sup> For FDLP, borrowers are considered to be in default on the 271st day of delinquency and are to be placed in the numerator of the default calculation at that time.

Each year, the Department assesses a school's eligibility to continue participating in FFELP and FDLP on the basis of the school's default rates for the most recent 3 consecutive years for which data are available. In fiscal year 1999, for example, eligibility is based on default rates for fiscal years 1994, 1995, and 1996. A school remains eligible if its rate is below the 25-percent threshold in at least 1 of these years. Most schools become ineligible if their default rate equals or exceeds the default threshold in all 3 fiscal years.<sup>7</sup> Some of the student borrowers placed in a cohort neither default nor make payments on their loans during the full cohort period. These borrowers include the following:

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<sup>5</sup>If a school has fewer than 30 borrowers entering repayment, the Department calculates a 3-year average default rate (see app. I).

<sup>6</sup>Before the enactment of the Higher Education Amendments of 1998 (sec. 429 of P.L. 105-244, effective Oct. 1, 1998), sec. 435(l) of the Higher Education Act of 1965, as amended, defined default as including failures to repay that had existed for only (1) 180 (rather than 270) days, in the case of a loan that was repayable in monthly installments, or (2) 240 days, in the case of a loan that was repayable in less frequent installments.

<sup>7</sup>The Higher Education Act exempted historically black colleges and universities, tribally controlled institutions, and Navajo community colleges from the threshold requirement through June 1999.

- Some borrowers are allowed to defer payment for an additional period because, for example, they are pursuing an approved course of study, trying but unable to find full-time work, or otherwise experiencing economic hardship. People having trouble finding work or experiencing other economic hardship may defer payment for up to 3 years, if they borrowed for the first time on or after July 1, 1993.
- Other borrowers may receive forbearance, which generally involves temporarily ceasing payment.<sup>8</sup> Borrowers may receive forbearance if, for example, because of poor health or other acceptable reasons, they cannot make scheduled payments. In certain circumstances, forbearance may be administratively granted by the Secretary of Education without requiring documentation from the borrower. For example, administrative forbearance may cover a period of national military mobilization or other local or national emergency. In other circumstances, forbearances are mandatory. For example, a lender must grant forbearance when a borrower is serving in a medical or dental internship or residency program and has exhausted his or her eligibility for deferment, or when a borrower's monthly loan payments are equal to or greater than 20 percent of total monthly income. Generally, a borrower may be granted forbearance for up to 1 year at a time.

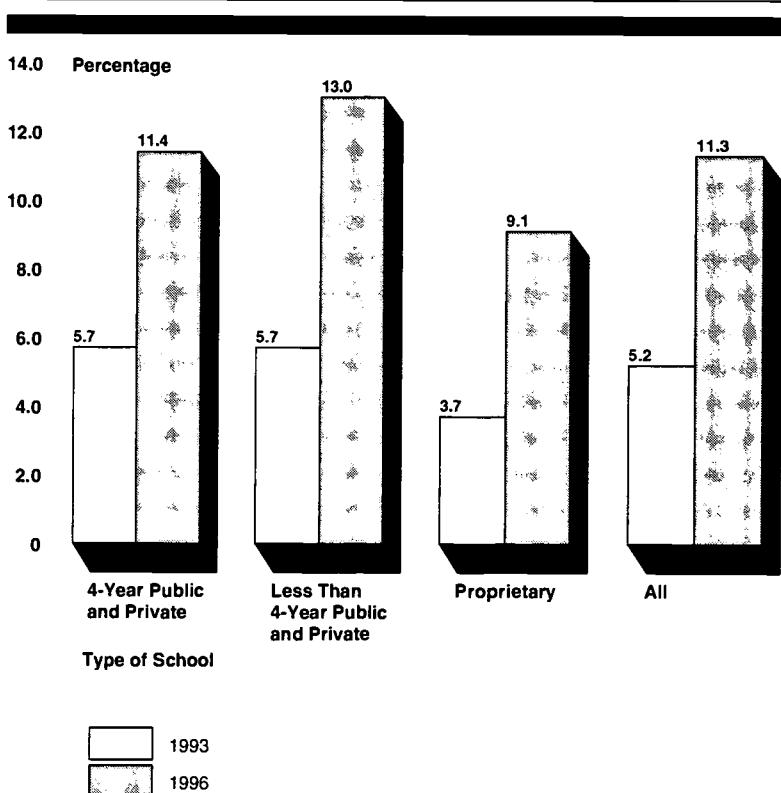
If the number of borrowers who have been provided deferments or forbearances becomes substantial, default rates can be affected in two ways. First, because these borrowers are not removed from the cohort, the default rate is lowered. This happens because they are counted as part of the total number of borrowers in the cohort who began repayment, even though they are not making payments on their loans. Second, because these borrowers are never placed in a subsequent cohort, they are never included in calculations of a school's default rate, even if they default on their loans after the deferment or forbearance period is over.

Department officials said they do not attempt to remove students whose loans are in deferment or forbearance from a cohort because it is Department policy to view such borrowers as a part of the repayment population. This policy is consistent with section 435(m) of the Higher Education Act, which defines the term "cohort default rate."

<sup>8</sup>Forbearance can also involve extending the payment period or making smaller payments. However, according to officials from five large loan servicing organizations, nearly all forbearance cases currently being processed involve temporarily stopping payment.

## Student Loans in Deferment and Forbearance Have Increased for All Types of Schools

**Figure 2: Borrowers in Deferment or Forbearance as a Percentage of Total Borrowers in Repayment, by School Type, 1993 and 1996 Cohorts**



Department officials attributed this rise in deferments and forbearances, in part, to various changes in the law instituted by the 1992 amendments that eased the requirements for obtaining deferments and forbearances. These changes included the simplification of deferment by reducing the number of deferment categories from 13 to 3, the provision for mandatory and administrative forbearances, and a broadened definition of economic hardship for deferments. For example, under the provision for mandatory forbearances, guaranty agencies are no longer given discretion in deciding

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whether to grant forbearances for certain conditions; they are required to grant forbearances, for example, to students who demonstrate a willingness to pay but are currently unable to do so, and to students who have exhausted medical and dental internship deferments.

Because proprietary schools have historically had more difficulty remaining under the default rate threshold, we examined whether their students might have become the borrowers most likely to seek loan deferments and forbearances as an alternative to default. However, in both cohort years 1993 and 1996, the percentage of students with deferments or forbearances was significantly less for proprietary schools than for other types of schools.

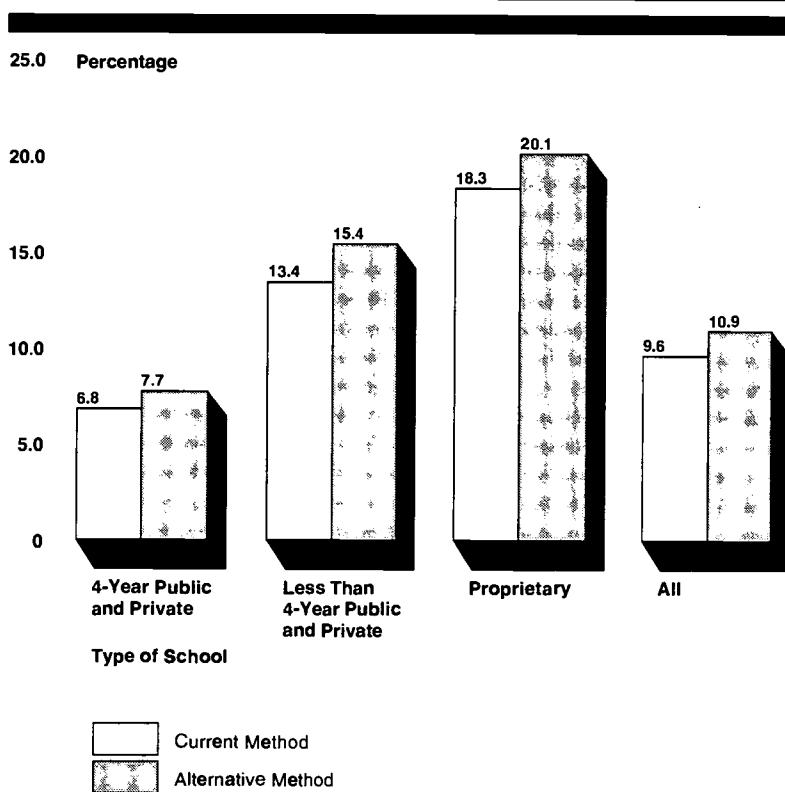
Although both deferments and forbearances increased between cohort years 1993 and 1996, the number of forbearances grew more. Overall, the number of borrowers who obtained deferments nearly doubled, from about 80,000 to 148,000, but the number who obtained forbearances quintupled, from about 16,000 to 80,000. These increases were generally similar across all types of schools.

We also attempted to determine what differences, if any, could be discerned between borrowers in FDLP and FFELP. Comparisons were limited, because FDLP is relatively new. No borrowers with FDLP loans were included in the 1993 cohort, but FDLP borrowers constituted about 3.9 percent of total borrowers in repayment for the 1996 cohort. For that year, FDLP borrowers in repayment were nearly three times more likely than FFELP borrowers in repayment to have had a deferment or forbearance. Although these early data indicate a potentially significant difference between the two loan programs, it is premature to conclude that a large difference will persist in future cohorts. Department officials said they believed this difference between FDLP and FFELP is due, in part, to the Department's Direct Loan Servicing Center's active use of deferments and forbearances as tools to facilitate the resolution of delinquencies to help minimize loan defaults. Additionally, the servicing center commonly uses administrative forbearances when correcting erroneous information generated by schools, the Department, or itself to ensure that borrowers are not unfairly penalized.

## Default Rates Rose When Borrowers With Deferments and Forbearances Were Excluded

Calculating default rates using an alternative methodology that excluded borrowers with loans in deferment or forbearance resulted in higher default rates. Using the current methodology for calculating cohort default rates, the overall rate for all schools in the 1996 cohort was 9.6 percent. When recalculated using the alternative method, the rate increased by 1.2 percentage points to 10.9 percent.<sup>9</sup> The increases were proportionately similar across the different types of schools (see fig. 3).

**Figure 3: Student Loan Default Rates Calculated Using Current and Alternative Methodologies, by School Type, 1996 Cohort**



Note: The current method includes borrowers with deferments or forbearances in its denominator; the alternative method does not.

The change in the default rate shows the effect of the alternative calculation methodology, which excludes borrowers with loans in

<sup>9</sup>The percentage point increase is 1.2, rather than the difference between the rounded percentages 10.9 and 9.6.

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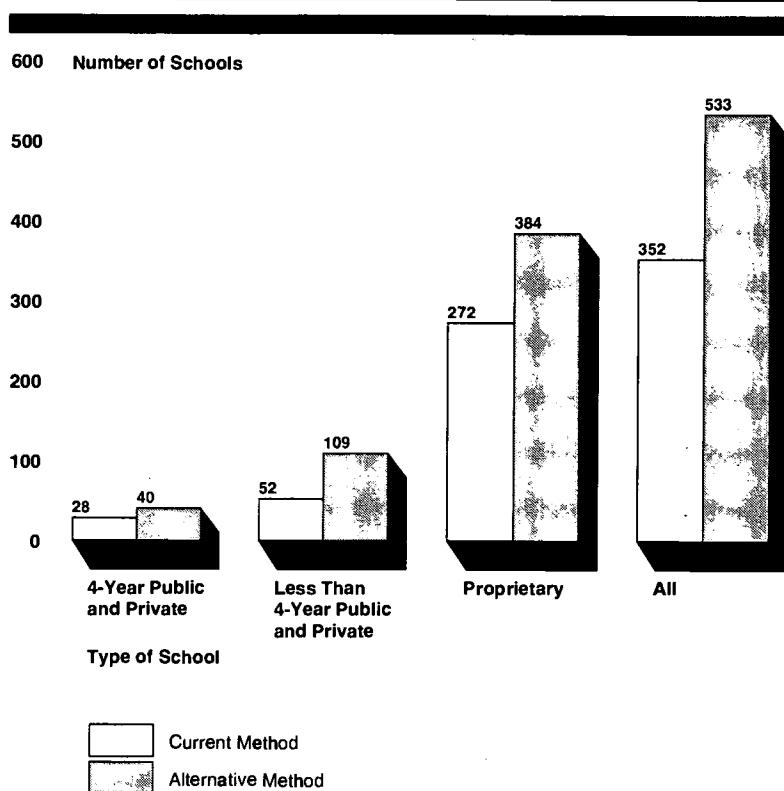
deferment or forbearance from the denominator (all borrowers who entered repayment) of the calculation. Because virtually no borrowers with loans in deferment or forbearance have to make loan payments, these borrowers do not, by definition, go into default and thus are excluded from the numerator (borrowers in default) under both the current and the alternative methods for calculating the default rate. The current methodology, however, retains all borrowers with loans in deferment or forbearance in the denominator, even though these borrowers are no longer making payments on their loans. As the percentage of borrowers with loans in deferment or forbearance increases, the difference that occurs in the rates computed under the two methodologies also increases.

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## Under the Recalculated Default Rate, More Schools Exceeded the 25-Percent Threshold

Excluding borrowers with loans in deferment or forbearance from the default rate calculation also had the effect of increasing the number of schools with default rates above the 25-percent threshold. Under the current methodology, 352 schools (out of 4,320) had default rates equal to or greater than 25 percent for 1996. When we excluded borrowers with loans in deferment or forbearance from the calculation entirely, the number of schools exceeding the 25-percent threshold rose by 181 (51 percent) to a total of 533 schools. As figure 4 shows, proprietary schools represented the greatest part of this increase: 112 of the additional 181 schools were proprietary schools. However, the percentage increase for proprietary schools was slightly less than the percentage increase for the other types of schools. The additional proprietary schools represented a 41-percent increase, compared with a 43-percent increase for 4-year schools and a 110-percent increase for less-than-4-year schools.

**Figure 4: Number of Schools Whose Default Rates Equaled or Exceeded 25 Percent When Calculated Using Current and Alternative Methodologies, by School Type, 1996 Cohort**



Note: The current method includes borrowers with deferments or forbearances in its denominator; the alternative method does not.

Department officials told us they did not favor changing the current method for calculating schools' default rates because the national default rate has fallen each year since 1991, and, at the same time, more than 1,000 schools have been removed from the programs because their default rates were too high. Department officials also said changing the method would create the following problems:

- The Department would have to modify its computer program at significant cost.
- Schools wanting to check the Department's calculations would create increased workloads because the schools would request additional information from the Department, lenders, and loan servicers.

- The number of schools that would challenge or appeal the default rate calculation would increase overwhelmingly. The Department estimated that the number of challenges and appeals would rise from the current level of 850 schools a year to at least 2,550 a year. The added cost of handling these challenges and appeals, Department officials estimated, would be more than \$1 million.

We do not believe that the Department's objections to changing the method of calculating the cohort default rate are compelling. The reasons cited are mainly administrative in nature and appear to be overstated. For example, those schools that would likely have a compelling reason to challenge or appeal on this basis are the ones that would move above the default rate threshold specifically because students in deferment or forbearance were excluded from the calculation. It is important to note that schools do not lose their eligibility to participate in FFELP and FDLP on the basis of 1 year's cohort default rate. A school becomes ineligible if its default rate remains at or above 25 percent for each of the 3 most recent years. Our calculations for the 1996 cohort showed that 181 schools would fall into this category in 1 year, and it is unknown how many schools might exceed the default rate threshold for 3 consecutive years. Whatever the actual number, it would be far less than the additional 1,700 challenges or appeals the Department estimates would occur as a result of changing the method of calculating the default rate. In addition, these 181 schools had over 12,000 borrowers who had defaulted on their student loans. Assuming an average loan size of \$3,500, the cost to the government to pay lenders' claims for these defaulted loans could exceed \$40 million. Even if only a modest number of these schools were disqualified from participating in federal student loan programs because their default rates exceeded the threshold for 3 consecutive years, the potential savings to the Department in reduced default claims could well exceed the costs of administering the change in the default rate calculation.

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## Conclusions

By definition, a borrower with a loan in deferment or forbearance is generally not required to make loan payments and, therefore, has no exposure to default during the time the deferment or forbearance is in place. Currently, these borrowers are included in the denominator when computing schools' cohort default rates as if they were still making payments. Excluding such borrowers from the denominator of the default rate is appropriate because, using the current calculation methodology, should these borrowers default later, the defaults will not be factored into subsequent cohort calculations. Reliance on the current calculation

method could allow schools to remain under the 25-percent threshold and to maintain their student loan program eligibility even if they would be ineligible if the default rate were calculated using the alternative methodology. Further, if the trend of an increasing number of borrowers' obtaining deferments and forbearances continues beyond the 1996 cohort, the impact of shielding high-default schools from exceeding the threshold will be greater in the future. This, in turn, could result in these shielded schools' continued participation in federal student loan programs and increased costs to the federal government as it continued to pay lenders' claims for loans that defaulted.

Although the Department believes that administering a change in the default rate calculation method would result in substantially increased costs, we believe the Department's estimates of increased costs are too high. Additionally, there could be net savings if, as we believe is likely, reduced default claims exceeded the anticipated increases in administration expenses. Consequently, we believe that borrowers with loans in deferment or forbearance should not be viewed as borrowers in repayment when the Department calculates schools' cohort default rates but should instead be removed from the cohort before calculating default rates. Also, these borrowers should be added to a subsequent default cohort in the year in which their deferments or forbearances end and they have begun repaying their loans.

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## Matters for Consideration by the Congress

The Congress may wish to consider amending section 435(m) of the Higher Education Act of 1965, as amended, to entirely exclude from the annual calculation of school default rates borrowers who are not in repayment by the end of a default cohort period because they have loans in deferment or forbearance. Additionally, the Congress may wish to require the Secretary to develop and implement procedures to ensure that borrowers excluded from a cohort's default rate calculation because of an authorized deferment or forbearance are included in a future cohort after they have resumed making payments on their loans.

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## Agency Comments

The Department of Education provided comments on a draft of this report. The Department agreed that default prevention measures should be revisited and stated that our report provided a helpful discussion of ways to measure student loan defaults. It also said that its Office of Inspector General is currently exploring an alternative method for calculating the cohort default rate, and that the Department plans to review both our

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suggestions and those of the Inspector General to determine if the use of the cohort default rate as a default management tool can be improved. In this regard, the Department offered reasons for maintaining the current calculation in the interim, issues to consider if a change in calculation method is implemented, and possible new strategies to reduce default costs. The Department's comments appear in appendix II.

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Copies of this report will be provided to the Honorable James M. Jeffords, Chairman, Senate Committee on Health, Education, Labor, and Pensions; the Honorable Richard W. Riley, Secretary of Education; and other interested parties. We will also make copies available upon request.

This report was prepared under the direction of Cynthia M. Fagnoni, Director, Education, Workforce, and Income Security Issues, who may be reached at (202) 512-7215 if you or your staff have any questions. Other staff who made key contributions to this report include Joseph J. Eglin, Jr.; Daniel C. Jacobsen; and Edward H. Tuchman.



Richard L. Hembra  
Assistant Comptroller General

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## Abbreviations

FDLP	William D. Ford Federal Direct Loan Program
FFELP	Federal Family Education Loan Program
NSLDS	National Student Loan Data System

# Scope and Methodology

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We obtained most of the data used to address our report objectives from the Department of Education's National Student Loan Data System (NSLDS) through the Default Management Division. Specifically, we obtained Loan Record Detail Report information (formerly referred to as backup data) for all schools with 30 or more borrowers in repayment for both the 1996 and 1993 default rate cohorts. We used the 1996 cohort because it contains the most recently published default data available on the extent to which borrowers in repayment were using student loan deferments and forbearances. The 1993 cohort was selected because it permits a 3-year time difference for comparison with the 1996 cohort and was readily available for our use.

The formula the Department uses for calculating a school's cohort default rate depends on the number of student borrowers from that school entering repayment in a given fiscal year. For a school with 30 or more borrowers entering repayment, the cohort default rate is the percentage that results from dividing the number of students who entered repayment in a given fiscal year and defaulted before the end of the next fiscal year (the numerator) by the number of students who entered repayment in that given fiscal year (the denominator). If a school has fewer than 30 borrowers entering repayment, the Department calculates an average cohort default rate. This average rate is the percentage that results from dividing the number of students who entered repayment in the 3 most recent fiscal years and defaulted before the end of the fiscal year immediately following the fiscal year in which the loan entered repayment (the numerator) by the number of students who entered repayment in the 3 most recent fiscal years (the denominator). Because of the complexities involved in re-creating the Department's average cohort default rate calculations for schools with fewer than 30 borrowers in repayment, we limited our analyses to schools with 30 or more borrowers entering repayment in both the 1993 and 1996 cohorts. We estimated that over 99 percent of the borrowers identified by the Department as being in repayment for these cohort years were included in our analyses.

The loan record report contained school identification numbers for each borrower but did not contain data on school level (that is, whether it was a 4-year, 2-year, or less-than-2-year school) or control (that is, whether it was a public, private nonprofit, proprietary, or foreign school). By using school identification numbers, we were able to obtain school level and control data from the Department's "FY 1994-1996 Cohort Default Rates" report, its Integrated Postsecondary Education Data System, and its

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Postsecondary Education Participant System database. Foreign schools were excluded from our analysis.

Our analysis of the number of schools that exceeded the 25-percent statutory threshold was based on 1996 cohort data only. We did not estimate the number of schools that could become ineligible to participate in federal loan programs under the alternative methodology because such a determination would have to be based on rates for 3 consecutive cohort years. We did not have loan records for the needed additional 2 years immediately before or after 1996 (neither 1994 and 1995 nor 1997 and 1998).

A methodological concern regarding forbearance status borrowers was addressed before we analyzed the numbers of borrowers for their deferment or forbearance status or calculated default rates that excluded deferred or forborne status repayers. The concern involved our inability to determine from both the 1993 and 1996 cohort loan records the type of forbearances that were represented by the borrowers in repayment. Depending upon the type of forbearance a borrower chooses, loan payments will temporarily cease or will continue in some form. To the extent that forbearances are the type that require no payments during the forbearance period, they prohibit a borrower from defaulting. Forbearances that do not require payments were the type that we intended to exclude from the denominator in making our alternative default rate calculations. Consequently, we devised a means for estimating the extent to which forbearances found within the 1993 and 1996 cohorts were the type that did not require loan payment during the forbearance period.

We contacted officials from five large student loan servicing organizations that, combined, according to the executive director of the Student Loan Servicing Alliance, collect and service about 70 percent of FFELP loans and 100 percent of FDLP loans. We asked these officials, given their companies' experiences as servicers of federal student loans, what percentage of borrowers in forbearance make no payments during the forbearance period. Responses from all five loan servicing organizations were essentially the same; nearly all forbearances, over 90 percent in one case and nearly 100 percent in four cases, were estimated to be the type that require no loan payments during the forbearance period. On the basis of these officials' experience, we determined that our methodology for analyzing forbearances could reasonably presume that all borrowers with forbearance status in the Department's 1993 and 1996 cohorts did not have to make loan payments during the forbearance period.

In calculating an alternative default rate, we excluded from the denominator all borrowers in repayment who had a loan in deferment or forbearance. The scope of our work did not include a consideration of when these deferrals or forbearances might end, thereby causing the loans to reenter repayment.

In addition to contacting loan servicers, we contacted various Department officials and an NSLDS computer specialist contracted by the Department, and reviewed laws, regulations, and Department procedures associated with the management and production of cohort default rates for postsecondary schools. Relying on Department procedures for ensuring data integrity, we did not validate the information and data obtained and used in our analyses. Schools, guaranty agencies, lenders, and FDLP services are among the primary organizations that provide data to NSLDS for use in calculating cohort default rates. These same organizations are afforded the opportunity to review draft cohort default rates before they are officially released to the public and to take action through adjustment or appeal requests to correct loan records in the NSLDS system that they believe are incorrect.

# Comments From the Department of Education



## UNITED STATES DEPARTMENT OF EDUCATION

THE DEPUTY SECRETARY

July 2, 1999

Ms. Cynthia M. Fagnoni  
Director, Education, Workforce,  
And Income Security Issues  
United States General Accounting Office  
Washington, DC 20548

Dear Ms. Fagnoni:

Thank you for the opportunity to review and comment on your draft report, *Student Loans: Default Rates Need to Be Computed More Appropriately* (HEHS-99-125). Your report is a helpful discussion of ways to measure student loan defaults.

The Department has worked to reduce the financial burden on students pursuing a college education. We have increased the amount of Pell grants and work-study assistance available to college students. We have also helped create the Hope and Lifetime Learning tax credits, restored the tax deduction for interest on student loans, and expanded the use of education IRAs. These efforts will significantly reduce the amount of money students must borrow to pay for their college education and make it easier for them to repay their loans.

We agree that it is necessary to support strong student loan default prevention measures that minimize federal default costs. We also agree with your general conclusion that default prevention measures should be revisited. The Department's Office of Inspector General (OIG) is also currently exploring an alternative method for calculating the cohort default rate. We plan to review both your and the OIG's recommendations together to determine if the cohort default rate can be improved.

### Benefits of maintaining the current calculation for the present.

The current cohort default rate calculation, which is prescribed by statute, has achieved its objective of identifying institutions that have extremely high current default rates. More than 1,000 schools were removed from one or more of the student financial assistance programs because their default rates were too high. In part because of these enforcement actions, the national default rates have been reduced each year since 1991, from a high of 22.4 percent to 9.6 percent.

There is a significant benefit to maintaining the current calculation. A consistent approach allows us to compare default rates across years, identify trends, and determine effectiveness of default prevention activities. Changing the default rate methodology would inhibit the data collection process and prevent the Department and our partners

*John G. Riley, Deputy Secretary*

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**Appendix II**  
**Comments From the Department of**  
**Education**

from performing comparative analyses of loan default data for management and public policy purposes.

**Issues to consider if a change in calculation method were to be implemented.**

As noted in your report, the proposed changes to the cohort default rate formula would result in additional schools losing eligibility to participate in the student loan programs, with the effect of the change felt in roughly equal measure across two-year, four-year, and proprietary institutions. Although the proposed change would likely result in fewer eligible schools, it would not necessarily better define "at risk" schools. Moreover, the removal of these schools may reduce access to postsecondary education for some students. Before implementing the change, it is important to ensure that the overall benefits — to students and the Federal taxpayer — of eliminating these schools outweighs the possible restrictions in educational opportunities for some students.

**New strategies to reduce default costs.**

Until recently, the Department measured its success in default prevention largely by the reduction in the statutorily-defined "cohort default rate." This rate was created to eliminate high default schools from the loan programs by measuring the number of borrowers that default within the first two years of the repayment period. Other federal credit programs and the financial service industry track default activity over the life of the loans and use this to measure the effectiveness of their default prevention strategies.

Using historical data from the National Student Loan Data System, the Office of Student Financial Assistance is now instituting a life-of-the-loan-default measurement system to analyze default activity by school, guaranty agency, lender, and the Department's own direct loan servicer. We believe this information will help us better understand variations in default patterns and devise new strategies to reduce default costs. If, based on this new information, we can take administrative or policy actions to encourage effective measures, we can drive down our budget costs. We are resolved in our mission to serve our most important customer -- the student while protecting public monies.

Again, we appreciate the opportunity to comment on the draft report. I hope that these suggestions are helpful.

Sincerely,



Marshall S. Smith  
Deputy Secretary (A)

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